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SUBJECT: THE NEW GOVERNMENT'S ECONOMIC TEAM STARTS WORK,
CLARIFIES PORTFOLIOS

Classified by Economic Counselor Scot Marciel for reasons 1.5
(b,d).

1. (C) Summary: Prime Minister Gul announced the portfolios of the state ministers, dividing supervision of the economic agencies between Deputy PM Abdullatif Sener (privatization, banking and capital markets boards), State Minister Ali Babacan (Treasury, Central Bank and main state banks), and State Minister Kursat Tuzmen (foreign trade). Babacan, with his office in the Treasury, is likely to inherit the Dervis role of coordinating with the IMF and World Bank, and being the economic program's public spokesman, though Sener and Finance Minister Unakitan are both close to AK Chairman Erdogan, and will have key roles in economic policy-making. Treasury U/S Oztrak told us he is impressed with Babacan, though he gives an initial mixed review on AK policy positions. The new team is good on privatization and foreign direct investment, but "need education" on IMF relations, tax reform, disinflation target, and banking sector reform. The last issue is critical, and Oztrak said he warned Erdogan in his initial briefing that the government must keep its hands off the BRSA. At a DCM-hosted iftar for AK parliamentarians this week, the deputies voiced differences on the primary surplus target of 6.5 percent of GNP. End Summary.

Treasury Undersecretary Impressed with New Team;
But More "Education" Work Ahead

2. (SBU) On November 19, Treasury U/S Oztrak told us his first contacts with the newly elected AK parliamentarians and new ministers were positive. At his and Central Bank Governor Serdengeçti's initial briefing of senior AK officials, including Erdogan, they listened carefully, took notes and asked good questions. Oztrak meets daily with State Minister Babacan who "talks the same language as me, learns quickly and is very sensitive to market reactions."

3. (SBU) Oztrak is also optimistic about progress on the macro targets. This year's growth could reach 6 percent of GNP (the formal target was increased from 3 to 4 percent last month). The growth story is a healthy mix of exports and pick-up of domestic demand. But 6 percent growth may raise concerns of the economy over-heating, he continued, thus providing another reason for keeping a high primary surplus of 6.5 percent of GNP for 2003. On meeting the year-end primary surplus, Oztrak said that last week's state enterprise price increases (tobacco and alcohol products, tea, and sugar) will "keep us close to the 6.5 percent target." (Comment: IMF resrep told us separately this is a "positive spin.") If the GOT keeps the 6.5 percent primary surplus in 2003, and markets stay positive, then Oztrak sees a chance to reduce public sector debt to GNP ratio - from the current target of 77 percent at year-end 2003 to the low 70s.

4. (C) On policy issues, Oztrak gave a preliminary mixed review of the new team. On the positive side, they sounded good on pushing the foreign direct investment and privatization agendas. There are, however, some concerns:

-- IMF relations. Oztrak understands the political need for calling for a new reform program, but he thinks the GOT should say: "the general framework of the existing program is working and we will preserve it." Within that framework, there is room per Oztrak to put more emphasis on socially vulnerable groups, to improve public sector governance and the investment environment. On scheduling an IMF mission, Oztrak wants to quickly finish the outstanding Fourth Review conditions before discussing the 2003 program. He believes Babacan wants a mid-December IMF mission to combine both the

Fourth Review and also a detailed program for 2003.
(Comment: Babacan told us he wants to hold informal talks with the IMF on the 2003 program without the Treasury staff and before a formal Mission, reftel. This may be unrealistic, since Babacan doesn't have all the information and numbers at his fingertips, like the Treasury staff.)

-- Disinflation. The GOT program needs to continue focusing on disinflation, per Oztrak, though the new ministers are not mentioning it. (Note: The pro-Islamist business association MUSIAD on November 20 announced that the 2003 GOT program should focus on "growth not inflation.") Current Central Bank projections, based on core inflation trends, show a 2003 year-end 26 percent CPI, whereas the program calls for 20 percent.

-- Tax Reform. Oztrak said instead of annulling the "financial year zero law," the new GOT should delay its scheduled January 1, 2003 implementation, and make it part of a direct tax reform package to be introduced in 2003. (Note: The financial year zero law, adopted in July 1998, is intended to register the underground economy. The law's implementation has been delayed and is now scheduled to enter into force on January 1, 2003, and gives Turkish residents a certain period to report to their local tax offices their unrecorded wealth without penalty. Septel covers the debate on this law.)

-- Banking Sector Reform. "AK is confused about the BRSA," Oztrak said. "I told Erdogan openly that continued restructuring of the sector is a key benchmark for the local and international financial communities. We can't afford any perception of flexibility." Oztrak said the concern is with Yapi Kredi, and he sees the problem as affecting Treasury's debt management capability: "If there's a sick player in the system, holding our papers, this puts pressures on the player to sell the papers, which increases the risk premium for everyone holding the papers." The banking sector's financial mediation role is key to growth in 2003, per Oztrak, thus the need to keep the GOT's hands off of the BRSA. (Comment: The new government has recently backed away from earlier criticism of BRSA.)

15. (C) Oztrak is uncertain of his future in the government. "They have to have confidence in me, and I have to have confidence in them." He told us PM Gul was the most reasonable person in the 1996/97 Refah-Yol government. "We in the bureaucracy used to come to him to solve all sorts of problems." On the other hand, DPM Sener (formerly Finance Minister) "just accepted whatever instructions Erbakan gave him."

Reinforcing the Issues with AK Parliamentarians

16. (C) Oztrak's mixed review of the new team's policy positions was reinforced during an iftar for AK parliamentarians hosted by the DCM. We heard some differences on economic policy between younger MPs Reha Denemec and Ibrahim Ozal, and the "old guard" Minister of Industry Ali Coskun. Ozal and Denemec thought the 2003 budget needed to keep the 6.5 percent of GNP primary surplus, whereas Coskun focused on the need for "pump priming." Coskun proposed that the primary surplus could be lowered, because real interest rates were coming down (he said the target was 10 percent) and the budget would cut public investment and agency spending. DCM suggested that the GOT budget needed to show fiscal discipline, and that the GOT shouldn't plan to spend savings that hadn't yet materialized.

17. (C) On the positive side, Industry Minister Coskun said the new GOT was committed to resolving foreign investment disputes. The draft Foreign Direct Investment law now in parliament would be revised "to be more liberal." The new GOT was putting together a list of 18 FDI disputes for immediate resolution. "You'll come to thank us," Coskun said.

State Ministers' Portfolios Announced

18. (U) On afternoon of November 21, PM Abdullah Gul announced the portfolios of the seven State Ministers (three of whom are also Deputy Prime Ministers). Following are the portfolios of the three with economic policy responsibilities.

State Minister and Deputy Prime Minister
Abdullatif Sener:

-- Directly supervises the State Planning Organization and
the Privatization Administration

-- Reports to Cabinet on following independent agencies:
Banking Regulation and Supervision Agency; Capital Markets
Board; Turkish Development State Bank

State Minister Ali Babacan:

-- Directly supervises the Treasury Undersecretariat

-- Reports to Cabinet on following independent agencies:
Central Bank; Ziraat and Halk State Banks
State Minister Kursat Tuzmen:

-- Directly supervises the Foreign Trade Undersecretariat and
the Customs Undersecretariat

-- Reports to Cabinet on following independent agency:
Turkish Ex-Im Bank
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